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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	

GTE's PETITION FOR RECONSIDERATION

GTE Service Corporation on behalf of its affiliated domestic telephone operating, long distance and wireless companies

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SUMMARY

GTE urges the Commission to reconsider its rule changes that would greatly increase the burdens of regulation at a time when price caps and competition have greatly reduced any risk to the ratepayer, as recognized by the FCC itself. GTE believes these rule changes would impose on GTE a million dollars in added internal and external costs. To avoid this unfortunate outcome, GTE suggests herein alternatives that would provide any necessary assurance to the Commission that the ratepayer will continue to be fully protected.

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GTE's PETITION FOR RECONSIDERATION

GTE Service Corporation on behalf of its affiliated domestic telephone operating, long distance and wireless companies ("GTE"), with reference to the Report and Order[1] (the "*Report & Order*") seeking to implement the Telecommunications Act of 1996 (the "1996 Act")[2], submits the following Petition for Reconsideration (the "Petition"). The Petition requests reconsideration of only those aspects of the *Report & Order* that adversely affect independent (non-BOC) Local Exchange Carriers ("Independents").

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1 Report and Order, FCC 96-490 (released December 24, 1996) in this CC Docket No. 96-150 ("D.96-150"), 1996 FCC LEXIS 7159.

2 All references to statutory sections or subsections are to 47 U.S.C. unless otherwise specified.

These concern rule changes in the Commission's *Affiliate Transaction Rules*[3] adopted by the *Report & Order* with regard to sections 271-276.

INTRODUCTION

As discussed at length in this Petition, *infra*, GTE is greatly concerned that the effect of the *Report & Order* will be, in practice, to impose on Independents a massive and completely unjustified increase in administrative costs and burdens without satisfaction of the heavy burden of proof set out by the Commission.[4] If the rule changes are implemented as stated, GTE believes this would cost GTE more than a million dollars a year, of which $500,000 represents the estimate of Arthur Andersen reflected in Exhibit 1 attached hereto (Arthur Andersen letter dated February 10, 1997)

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3 Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111 ("D.86-111"), Report and Order, 2 FCC Rcd 1298 (1987) (the "*Joint Cost Order*"), *modified*, Order on Reconsideration, 2 FCC Rcd 6283 (1987) (the "*Joint Cost Reconsideration Order*"), *further recon.*, Order on Further Reconsideration, 3 FCC Rcd 6701 (1988) (the "*Joint Cost Further Reconsideration Order*"), *aff'd sub nom.* Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). *See* 47 C.F.R. sections 64.901-903.

4 "[A]ny commenter urging [the FCC] to adopt more detailed accounting safeguards than those in [its] current rules or those specifically mandated by the [1996] Act bears a heavy burden in demonstrating the necessity to adopt such safeguards." *Report & Order* at paragraph 27.

and the remainder represents internal GTE staffing requirements.[5] This is in direct opposition to the intent of the Commission and the direction of the 1996 Act.

GTE maintains it is a mistake to increase regulatory burdens on Independents just when, as recognized by the Commission itself, the need for regulation is diminishing by virtue of price caps and competition. Thus, as observed by the *Report & Order* at paragraph 145 (*footnote omitted*): "Since the adoption of the affiliate transactions rules, we have adopted price cap regulation that gives the largest incumbent local exchange carriers efficiency incentives far stronger than those the

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5 Arthur Andersen says: "[W]e currently estimate that our audit fees will increase by approximately $500,000 in order to comply with Docket 96-150. Assuming that GTE performs the fair market value studies (or contracts with another consultant to perform the studies), we believe our fees would still increase by approximately $150,000 to $200,000 in order to cover the cost of testing the studies." In addition, GTE has in hand bids from consulting firms offering to do the required market studies (though with less detail than might be required) for amounts ranging from $150,000 to $400,000 for a single affiliate (GTEDS).

valuation methods for affiliate services sought to preserve."[6] Moreover, the rule changes that will increase burdens are not adopted with any clear indication of *sunset*. So far as anyone can judge, these burdensome requirements will stay indefinitely.

A peculiarity of the *Report & Order* is it insists on aggregating Bell Operating Companies ("BOCs") -- which are subject to specially created statutory requirements -- and Independents, which are not subject to such requirements. The unintended effect is to give better treatment to BOCs than to Independents. Thus, paragraph 137 of the *Report & Order* grants BOCs an effective dispensation ("a rebuttable presumption") from the *fifty percent condition* (that products or services furnished to a carrier by an unregulated affiliate may not be valued for regulatory purposes based on "*prevailing price*" unless external sales of that affiliate are greater than fifty percent). This dispensation or "rebuttable presumption" is based on the fact that BOCs are bound by

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6 Further, in addressing the deregulatory mandate of section 161(b)(2)(A), the FCC has reached the tentative conclusion that price caps -- with or without sharing -- together with increased competition justifies significant reductions in regulatory requirements under section 214. Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996, CC Docket No. 97-11 ("D.96-11"), Notice of Proposed Rulemaking, FCC 97-6 (released January 13, 1997), 1997 FCC LEXIS 195 (the "*D.97-11 Notice*"). "Although price-cap regulation that includes a sharing option preserves some of the incentives toward 'gold-plating' that accompany rate-of-return regulation, we believe that <u>all forms of price cap regulation nevertheless reduce these incentives</u>.... Virtually all of the price-cap carriers have adopted the 'no-sharing' X-factor. This fact seems to indicate strongly that, in general, the benefits associated with the no-sharing option exceed the benefits of adopting a sharing option and strategically overinvesting in facilities. Moreover, we expect that growth in competition for local exchange and interstate access will provide <u>additional incentives for the price-cap LECs to increase their efficiency</u>. Therefore, whether a price cap carrier elects a 'sharing' or 'no sharing' option, we tentatively conclude that additional regulation under Section 214 is not required to protect telephone service ratepayers adequately against potentially higher rates resulting from investment in unnecessary facilities." *D.97-11 Notice* at paragraph 41, *emphasis added*.

section 272 to charge the same price for the same service whether furnished to "affiliates [or] third parties."[7]

In substance, GTE is already committed to the same kind of requirement by virtue of its Cost Allocation Manual ("CAM") and state requirements. By virtue of these, GTE commits that charges by affiliated vendors to the GTE telephone companies shall not exceed (and typically are less than) charges for the same products or services furnished to unaffiliated parties. Other Independents may already make such commitments and/or might be willing to accept such commitments for the sake of this rebuttable presumption that allows employment of the sensible *prevailing price* rule that the Commission has now re-adopted as indeed performing an important role. Rather than insisting on an arbitrary and rigid *fifty percent condition*, which as shown *infra* is alien to the logic of *prevailing price* and would essentially remove it as a feasible option, the Commission should decide to treat the Independents at least as favorably as it treats the BOCs.

Two GTE affiliates sell more than $1.5 billion in products and services to the GTE telephone companies. They sell over $345 million to unaffiliated parties. The notion that $345 million in sales do not constitute, in the words of paragraph 134, a "substantial quantity of business" would be a puzzling reading of the English language. In any approach to the question, the Commission should recognize at the outset that

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7 "Because the rates for services subject to section 272 must be made generally available to both affiliates and third parties, we adopt a rebuttable presumption that these represent prevailing company prices. Accordingly, products and services subject to section 272 <u>need not meet the 50 percent threshold</u> in order for a BOC to record the transaction involving such products and services at prevailing price." *Report & Order* at paragraph 137, *emphasis added.*

transactions in these dimensions represent evidence of the legitimacy of pricing in market terms, and will be so considered by any court.

If any further safeguards are determined to be required, apart from GTE's commitment discussed *supra*, GTE continues to suggest the following alternative: the *fifty percent condition* would not have to be met in any year in which (1) the total amount of unaffiliated party sales exceeds a specified amount (for GTE, $5 million)[8]; or (2) a specified number (twenty-five in the case of GTE) of unaffiliated customers each purchase in excess of $100,000 per year. These two conditions are consistent with the logic of the *prevailing price* rule in that they focus on the motivations of the unaffiliated purchasers, and thus show the legitimacy of pricing in terms of market reaction. A third possibility is that the average annual growth rate of the affiliated vendor's external sales exceeds the industry average growth rate. Some combination of these elements could give meaning to the *prevailing price* rule.

Also critical is that the provisions addressed in paragraph 147-148 be reexamined to permit the carrier to furnish to its affiliates administrative service priced at fully allocated cost (including the allowed interstate return) without having to incur the wholly unnecessary cost of market evaluation. This simple and workable safeguard has represented adequate protection for the ratepayer for decades; the Commission should not make this a still more burdensome requirement now that the risks to ratepayers -- for all the reasons identified by the Commission in the *Report & Order* as well as in

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[8] GTE is offering specific numbers for itself. A $5 million figure would plainly not fit a much smaller company. The specific figures for a company could be recorded as part of a CAM process.

D.97-11 -- have been sharply reduced. For administrative transactions in either direction, the fully distributed cost provision is more than enough protection.

GTE respectfully urges the Commission to reconsider the specifics of its rules and to make those specifics harmonize with and carry out the Commission's intent.

DISCUSSION

1. The massive increase in regulatory burdens that would be produced by the rule changes of the *Report & Order* conflicts with the FCC's own standard and with the deregulatory thrust of the 1996 Act.

The *Report & Order* (at paragraph 27), seeking to implement the 1996 Act, concludes that: "[A]ny commenter urging [the FCC] to adopt more detailed accounting safeguards than those in [its] current rules or those specifically mandated by the [1996] Act bears a heavy burden in demonstrating the necessity to adopt such safeguards."[9] Applying this sensible rule, the Commission (at paragraphs 50 and 108) rejects a wide range of burdensome proposals.

But when it comes to the proposals of the Notice of Proposed Rulemaking ("NPRM"),[10] this sensible rule is not applied consistently. Indeed, far from avoiding more detailed accounting safeguards, the *Report & Order* adopts several rule changes that would lead to a massive increase in regulatory burdens for GTE (and perhaps other Independents as well), in terms of both out-of-pocket cost and recordkeeping, in violation of the whole thrust of the 1996 Act as well as the intent of the Commission as expressed in the words quoted *supra*. As mentioned *supra*, GTE's two most important

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9 *Footnote omitted.*

10 Notice of Proposed Rulemaking in this D.96-150, 11 FCC Rcd 9054 (1996).

unregulated affiliates for these purposes are (1) GTE Supply, which had 1995 sales of $908 million, of which $200 million was to unaffiliated parties; and GTE Data Services (GTEDS), which had 1995 sales of $924 million, of which $145 million was to unaffiliated parties.

By introducing the *fifty percent condition* into the *prevailing price* rule, the *Report & Order* essentially eliminates this common-sense and equitable way of controlling regulatory burdens. Further, in contrast with current FCC rules that, on the transfer of an asset from the carrier to an unregulated affiliate, or in the opposite direction, require the asset to be valued at fully distributed cost or fair market value, whichever is the more unfavorable to the investor, the *Report & Order* would extend this requirement to services. The effect of subjecting services as well as assets to a Fair Market Value requirement will be to bring $1.5 billion in GTE transactions within the scope of this requirement, when no need to do so has been documented in this proceeding.

The consequent cost to GTE of complying with the changes represented by the *Report & Order* -- estimated at one million dollars -- disproves the claim that the rule changes of the *Report & Order* do not increase the burdens of regulation. These new rules would create the need for a regulatory accounting function within each nonregulated affiliate. The job tasks of this new function would include elements such as: Cost of accounting detail to support cost/price analysis at the product level; cost to monitor meeting a fifty-percent test at the product level given uncertainty; and cost to renegotiate annually a hundred affiliate contracts based on changes in market price.

Now, with all risks to ratepayers involving Independents sharply reduced by virtue of price caps, the requirements of the 1996 Act, and competition, the *Report &*

Order resuscitates arguments made and rejected in 1987.[11] Looking at the real impact of rule changes adopted by the *Report & Order*, it appears that -- in violation of the Commission's policy decision -- regulatory burdens are to be increased as price caps and other developments dramatically reduce the likelihood of any adverse impact on ratepayers of any action Independents might take. In other words, a higher fence must be built as the wolf loses his teeth.

The Commission understands that price caps without sharing effectively breaks the link (as intended) between incremental cost increases and the carrier's ability to raise rates or forego price reductions. GTE has elected price caps without sharing for tariff entities comprising slightly more than half its interstate operations. And tariff entities comprising the great majority of the remaining GTE operations have pricing well below their price cap level. For example, GTE California's prices are in total $67 million below the price cap level. Thus, as a practical matter, there exists for GTE a sharp reduction in public interest concern because increasingly there is a break in that link characteristic of rate-of-return regulation between (i) incremental cost increases and (ii) the carrier's ability to raise or maintain rates. At the very least it must be said that, just as the risk of overinvestment in facilities has diminished to a point justifying reduced regulation under section 214 in *D.97-11*, the likely adverse impact of any action by GTE is far smaller than what existed when rate of return regulation closely linked incremental cost increases and a carrier's effective return, and this justifies a reduction in regulatory burdens, not an increase. It is significant that in a different context the

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11 *See*, for example, *Report & Order* at paragraphs 144-148

Commission has stressed the reduction in regulation justified by "all forms of price caps."[12]

What is missing in the *Report & Order* is a serious effort to determine the cost of the higher fence said to be needed to guard against a toothless wolf. Thus, the *Report & Order* seizes the opportunity offered by a statute calling for the elimination of unnecessary regulation (sections 160 and 161; sections 10 and 11 of the 1996 Act) to reintroduce and adopt in substance items rejected nearly ten years ago, items that are also some of the very same proposals offered in 1993 by the *Affiliate Transactions Notice.*[13] In light of strenuous industry objections and the substantial costs parties maintained would be incurred, the Commission wisely suspended for several years its consideration of the extreme proposals of that proceeding. Now the *Report & Order* applies to Independents the substance of these extreme proposals in violation of the spirit of sections 160 and 161, which call on the Commission to eliminate unnecessary regulation.

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[12] *See* the quotation from the *D.97-11 Notice* at paragraph 41, *supra.* On internal inconsistency as a grounds for reversal, *see* AT&T v. FCC, 836 F.2d 1386, 1393 (D.C. Cir. 1988), *conditional application for review denied*, No. 85-1778, Slip Op. (November 2, 1988).

[13] Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, CC Docket No. 93-251, Notice of Proposed Rulemaking, 8 FCC Rcd 8071 (1993) (the "*Affiliate Transactions Notice*").

2. The *Report & Order* turns the Commission's logic inside out by preserving the *prevailing price* rule but then adopting an arbitrary *fifty-percent condition* that has the same effect as rejection.

On a second level the effect of the rules now adopted conflicts with the Commission's own policy as expressed in the *Report & Order,* which correctly determines (at paragraphs 132-133) that the *prevailing price* rule should not be eliminated because of the important benefits that rule provides.[14] But then paragraph 135 adopts a wholly arbitrary *fifty percent condition* that eviscerates the effect of the Commission's sound decision in favor of *prevailing price* by generally eliminating *prevailing price* as a practical option.

The essential logic underlying the *prevailing price* rule is that significant numbers of transactions in which unaffiliated firms purchase a product at a given price show that the price is competitive in market terms. Thus, when there are transactions reflecting dollar amounts in the hundreds of millions, this shows conclusively that the *prevailing price* rule has been satisfied. This rule represents a sensible way to simplify the process of testing out the validity of affiliate pricing in terms of market reaction.

The essential logic of *prevailing price* does not depend on the motivation of the affiliated vendor. It looks at the motivation of unaffiliated purchasers. This rule proceeds on the sensible assumption that well-managed companies do not throw their money away. Indeed, it is the practice of well-managed firms to make a careful selection of vendors in order to provide the purchasing company with the best bargain

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[14] It is significant that such parties as AT&T, TIA, Puerto Rico Telephone, American Public Communications Council and Sprint joined the BOCs and GTE in opposition to eliminating the *prevailing price* rule. *See Report & Order* at paragraphs 129-130.

available to obtain that balance between product cost and product quality (reliability, flexibility, and so forth) that meets the objectives of that purchasing company. This reality has an effect on the vendor, which must be attentive to the purchaser's particular balance of these factors in order to make sales. The core value of *prevailing price* is that it proves market reality (that the price is a fair price in market terms) by means of market reality (unaffiliated parties' self-interested purchasing decisions in substantial amounts). By definition, this is a form of evidentiary support superior to estimates and guestimates of value that are subject to judgmental factors, bias and the like. Instead of endless controversies over the details of accounting transactions and instead of intrusion into the affairs of unregulated firms, *prevailing price* uses these actual decisions of unaffiliated purchasers acting in their own interests as a sensible and simplifying benchmark.

The *fifty percent condition* purports to fit within the logic of *prevailing price*, but it is in fact a complete misfit. Imposing this arbitrary condition means that transactions with unaffiliated firms even in the hundreds of millions of dollars shall not be accepted as proving the validity of affiliate pricing in market terms -- or even as evidence of such -- unless these transactions represent in the aggregate fifty percent of the selling affiliate's sales. Without acknowledgment, adoption of the *fifty percent condition* switches the logical base of the rule from looking at the motivation of unaffiliated firms spending millions of dollars to the motivation of the affiliated vendor. This point emerges from the obvious *non sequitur* of paragraph 134 as between these two sentences: "A substantial quantity of business must be conducted with unaffiliated third parties in order to establish a true prevailing price. [*Non sequitur:*] Specifically, if the percentage of third-party business is small, there can be no assurance that the price agreed upon by the carrier and its affiliate represents the true market price...."[15] This statement -- "there can be no assurance ...." -- is transparently wrong. A showing of substantial sales volume can be made many different ways in harmony with the logic of the *prevailing price* rule -- starting with the most obvious: submitting data showing real transactions, real purchases by unaffiliated firms having no motivation to purchase products that are overpriced relative to whatever is available on the market.

This is not an academic question. As mentioned *supra*, GTE's unregulated affiliates, GTE Supply and GTE Data Services (GTEDS), sell respectively more than $200,000,000 and $145,000,000 to unaffiliated parties every year. This is a massive vote of confidence in the quality and price of the products they offer to the marketplace. But the *Report & Order* insists that, unless a fifty percent ratio is achieved -- an arbitrary ratio having no connection to the logic of *prevailing price* and no connection to establishing market reality by examining actual purchasers by unaffiliated parties in substantial amounts -- these sales will not establish, nor even represent evidence of, prevailing price.

As GTE has been arguing for years,[16] there is nothing in the phrase "substantial quantity of business" that conveys the notion that this must represent a specified ratio

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[15] *Footnote omitted.*

[16] A curious anomaly of the Report and Order is its significant quotation of GTE's objections based on the logic of *prevailing price* appear only in paragraph 151, where the Fair Market Value test is being addressed. This might mislead the reader into thinking GTE was objecting only to the Fair Market Value aspect of this matter. In fact, GTE's pleadings unmistakably addressed the *prevailing price* rule. See GTE's comments (at 4-8); and reply comments (at 3).

of the selling affiliate's sales, much less fifty percent. Plain English as well as the common sense in which the rule is grounded says external sales in the aggregate exceeding $345 million annually constitutes a "substantial quantity of business" by any definition known to man, whether this represents five percent of the vendors' sales or seventy-five percent. No court -- absent introduction of an arbitrary ratio -- would conclude that aggregate sales of these dimensions do not represent "a substantial quantity of business." And no court would conclude that the only way of making a probative showing of substantial sales is if this arbitrary ratio standard -- completely alien to the logic of the rule itself -- is met.

The *fifty percent condition* purports to implement the *prevailing price* rule but in fact it subverts the rule. To avoid this result, GTE urges to consider the alternative safeguards discussed in the Introduction, *supra*.

3. The *Report & Order* again departs from its own logic when it requires market valuation for services.

In another part of the *Report & Order* again a massive increase in regulatory burdens makes its appearance in disguise and similar concepts come into play. Under current rules, in the event of an asset being transferred from the regulated firm to an unregulated affiliate, the asset must be valued at the higher of cost or fair market value.[17] While this rule is unfair, its adverse impact is limited because currently it has no application to services, and asset sales are relatively rare. But the *Report & Order* -- resurrecting the extreme proposals of D.93-251 -- enormously expands the scope of the

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[17] The theoretical rule also involves tariffs and prevailing price, but on the occasional sale of an asset tariffs and prevailing price are not involved.

rule to include services as well as assets. This again reverses a decision made nearly ten years ago before price cap regulation gave exchange carriers "efficiency incentives far stronger than those the valuation methods for affiliate services sought to preserve."[18] The effect, then, is to extend this inherently unfair and burdensome requirement across the board to an immense range of transactions -- with only a limited exception for the selling affiliate that "exists solely to provide services to members of the carrier's corporate family."[19] And yet the *Report & Order* says it does not increase regulatory burdens.

This provision would bring within these burdensome rules a great range of transactions where the GTE telephone companies provide such services as legal advice, regulatory guidance, human resources administration, compliance review and the like, charging the unregulated affiliate cost plus the allowed return. These services (i) allow the overall company the efficiencies of dealing with a broad scope of employees and a broad scope of issues; (ii) allow convenient location of employees of similar or related disciplines, so that executives engaged in insurance, for example, or human resources or accounts payable or purchasing can broaden their professional experience; and (iii) allow these essential support services to spread fixed costs over a large transaction volume, thereby reducing the unit price to ratepayers. From the carrier point of view, since the company is recovering the cost incurred plus the allowed return, the activity is as profitable as the main company business but not more

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[18] *Report & Order* at paragraph 145.

[19] *Id.* at paragraph 148.

profitable. The degree of ratepayer protection provided by this rule has been deemed adequate for years, and nothing has happened to justify a dramatic increase in burdens -- certainly nothing that meets the Commission's burden of proof set out in paragraph 27 of the *Report & Order.*

The same principle should apply when the transaction occurs in the opposite direction. Fairness demands that the unregulated entity should be able to charge the carrier for administrative services on the same basis -- and without conducting a market analysis. With the same essential rule governing transactions either way, this would make both sides essentially indifferent to whichever firm is being served.

The asymmetric rule reflected in paragraph 148 of the *Report & Order* permits an exclusion from the market valuation requirement but only in narrow terms that seem to be tailored to the corporate structure of the BOCs. Only if an unregulated affiliate "exists solely to provide services to members of the carrier's corporate family" would its provision of services to the carrier be excluded from the requirement to value the transaction for regulatory purposes at the lower of fully allocated cost or fair market value. In the case of GTE, while many services are furnished to the GTE telephone companies by GTE Service Corporation ($205 million in 1995), far greater are the services discussed *supra* furnished by GTE Supply and GTEDS, both of which also sell products and services externally. The effect of this asymmetric rule is that about $1.5 billion in annual transactions (*i.e.*, $1,832 billion in combined 1995 revenue of GTE Supply and GTEDS minus $345 million representing their combined affiliate transactions) will be subjected to the fair market value requirement. The consequent heavy cost of complying with this requirement – compliance that would involve other

GTE affiliates as well -- disproves the claim that the rule changes of the *Report & Order* do not increase the burdens of regulation. Most of the million dollars in added cost which GTE expects to be caused by compliance with the *Report & Order* would be generated by this unnecessary function of assessing market value.

Rather than the infrequent case of single tangible items being sold to an affiliate, under the *Report & Order* market evaluation of services would become part of the everyday business of an Independent. Even confidential and individualized services such as payroll and human resources provided by the carrier affiliate, together with purchasing or data processing provided by the unregulated affiliate, would come under a market test requirement.

Applying the same market valuation test to services, with consequent costly market studies, makes even less sense now than when this was considered and rejected ten years ago. With any risk to the ratepayer sharply reduced by price caps and competition, this major increase in accounting and administrative burden is unjustified and conflicts with the deregulatory mandate of the 1996 Act expressed in sections 160 and 161. GTE suggests the 1996 Act does not contemplate an increased level of regulatory micromanagement where the supposed benefits are slight, if they exist at all. The *Report & Order* could increase GTE's internal and external costs by a millions dollars with no countervailing benefit for the ratepayer.

On still another point, the *Report & Order* is inconsistent with its own logic. Paragraph 154 recognizes that *prevailing price* is valid evidence of market value without the *fifty percent condition*. Thus it is clear that the value of *prevailing price* evidence is not dependent on the arbitrary fifty percent ratio. Indeed, typically the most reliable way to obtain fair market value of a service (when practical) is to offer the service to the market and see what the market is willing to pay. This is the logic the commission itself used in creating the *prevailing price* rule, and it is sound logic based on experience.[20]

Thus, paragraph 154 recognizes the value of the *prevailing price* rule without rigidly prescribing a ratio limitation not connected to the logic of the rule. The question being asked in paragraph 154 is not different from the key question asked in paragraphs 144-147, namely, What is a fair valuation method? The two paragraphs give two different answers without explanation. GTE submits that paragraph 154 gives the better answer -- that the arbitrary fifty percent ratio has no valid logical relationship to the *prevailing price* concept. GTE suggests paragraph 154 substantiates the proposition that the *prevailing price* rule -- without arbitrary ratio requirements -- represents just what the FCC thought it was in 1987 when the rule was adopted: a fair and workable benchmark that will ensure the ratepayer is not being ripped off.

The extension of the fair market value rule to services would dramatically increase the whole scope of regulatory intervention just as the risks ostensibly being guarded against diminish, and without identifying any solid reason why such an extraordinary backwards shift in Commission policy is justified. When this change in the rules is set beside the burden of proof established by paragraph 27 of the *Report & Order*, quoted *supra*, that anyone arguing for increased regulatory burdens "bears a heavy burden in demonstrating the necessity to adopt such safeguards," it becomes

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[20] Another valuation method is looking at the pricing of similar services -- or services that perform similar functions -- provided by other vendors; however, this method involves the complication of whether the services are fully comparable.

clear this change does not come close to getting over this hurdle. For ten years -- when the risk of adverse effects under rate of return regulation were far greater than they are now -- the Commission protected the ratepayer by a rule limited to assets. Now, when the need for such measures to protect the ratepayer is greatly reduced, the *Report & Order* increases the regulatory burden. The *Report & Order*'s perfunctory discussion in support of this astonishing and internally inconsistent change does not meet the FCC's own standard, for the driving factor is the mere possibility of adverse effects devoid of any assessment of likelihood.[21]

The fundamental inequity of the program should be kept in mind. An important reason why the D.C. Circuit upheld the FCC's valuation rule involving assets was because there seemed to be little chance of real impact.[22] But now the scope of the inequity is to be further broadened. Decreeing that services as well as assets are to be evaluated always on the more unfavorable basis to the stockholder is a high-handed exercise of raw power not typical of the FCC. Action of this kind -- falling only on the

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[21] Thus, paragraph 145, again making skillful use of the *non sequitur*, recognizes that since 1986 the FCC has adopted price cap regulation "that gives the largest incumbent[s] ... efficiency incentives far stronger than those the valuation methods for affiliate services sought to preserve"; then follows this as if it flowed logically with a reference to a "re-evaluation" suggesting current treatment of services "may in fact reward a carrier." Later the same paragraph says current valuation rules "may entice a carrier" and ratepayers "may ... be harmed." Notwithstanding the potency of the efficiency incentives of price caps, notwithstanding the de-regulatory direction of the 1996 Act, the *Report & Order* insists the Commission must adopt the severe regulations it rejected in 1987 and was unwilling to adopt in 1993. This procedure raises legions of questions for which no answer appears in the *Report & Order*.

[22] In Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990), the Court noted (at 1381) that the FCC "expects the residual rule to apply 'in a limited number of cases'...."

Incumbent Local Exchange Carriers -- will make a level playing field impossible. It is just the sort of arbitrariness that today's regulators should be getting away from, and the FCC should be leading the way in the right direction.

4. GTE urges the Commission instead to address how it can eliminate unnecessary regulatory burdens.

GTE's comments (at 10-13) and reply comments (at 4-5) urged the FCC -- insofar as Independents are concerned -- to examine how it might apply its new powers and deregulatory mandate under sections 160 and 161. GTE suggested a new set of rules should be considered focused on a realistic appraisal of the risk to the ratepayer. As this risk diminishes, the Commission should be turning its attention to clearing away the underbrush of endlessly detailed rules that then are pursued through endlessly detailed audits. In other proceedings, the Commission has sought to reduce regulatory burdens.[23] Here, while the FCC wisely rejects proposals of interexchange carriers designed to tie the Independents up in knots, the *Report & Order* adopts Staff-proposed changes in the rules that would vastly increase regulatory burdens. And there is no trace of a planned sunset for exhaustively detailed regulatory review; indeed, for this purpose there appears a new sunrise.

The heavy expenditures required for regulatory accounting should have some plausible and demonstrable bearing on protecting the ratepayer from risk; and accordingly should scale down as the risk reduces -- not increase, certainly not massively increase. Here, regulatory burdens increase as risks diminish – going in the

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[23] *See for example* Revision of Filing Requirements, CC Docket No. 96-23, Report and Order (By Chief, Common Carrier Bureau), DA 96-1873 (released November 13, 1996), 1996 FCC LEXIS 6274; and the *D.97-11 Notice.*

wrong direction. The increase in burdens is not identified as temporary or transitional. And the *Report & Order* refuses to give a commitment of any kind to a phase-down even in principle.

To pave the way for the elimination of intrusive regulation, the FCC should consider interim measures applying the concept of a *test-impact benchmark* proposed by GTE in its comments (at 10-13) and reply comments (at 4-5). This means the FCC's rules would be carefully grounded on assuring protection of the interstate ratepayer, and thus would self-limit their application so that, where there is no plausible likelihood of significant adverse impact on the interstate ratepayer, the regulatory intrusion will stop.

5. The *Report & Order* creates confusion by using a "one-size-fits-all' approach that insists on interweaving treatment of Independents -- which are not affected by the BOC-related provisions of the 1996 Act -- and treatment of the BOCs.

The *Report & Order* insists on applying virtually the same regulatory regime to BOCs and to Independents. Indeed, BOCs and Independents are repeatedly spoken of as if the same statutory rules apply to both. *See for example* paragraph 147. It appears that the massive increase in regulation for the Independents reflected in the *Report & Order* is based on aggregate logic, *i.e.*, that the BOCs and the Independents should be -- or even must be -- treated in the same category, or in the same way. But that is not the signal given by Congress, which subjected the BOCs to extensive requirements not applicable to the Independents. And at times Independents are treated less favorably than BOCs. See paragraph 137, discussed *supra*.

GTE's concerns expressed in its comments (at 1-4) and reply comments (at 4-5)[24] urged the FCC to consider the Independents in a separate proceeding -- or in a separate phase of D.96-150 -- where they would be caught up in the same regulatory mix as the BOCs. The *Report & Order* rejects this argument, and the long arm of the regulator thus reaches through a federal statute mandating reduced regulation and places generally as heavy -- sometimes even heavier -- a burden on the Independents as on the target intended by Congress.

GTE believes the record it has created over the past ten years shows the efficiency of using affiliates to obtain and furnish goods and services. Various GTE affiliates have to their credit a Malcolm Baldridge Award and an award as the most efficient data center in the United States. These accolades emerge from the active participation of GTE affiliates in business outside of regulation. The vast body of customers purchasing from GTE's unregulated affiliates is testimony to their service quality and price. Evidence of these benefits has also been recently noted in affiliate audits conducted by various state commissions. The unfortunate changes in FCC rules, discussed *supra*, may serve to pressure GTE to make changes in its corporate structure in order to minimize the burdens. Thus, instead of being neutral, regulation would push the company toward changes it would not otherwise make, and might very well reduce the benefit to ratepayers.

Placing BOCs and Independents on the same regulatory footing is a fundamentally erroneous and unfair way to approach the task given the Commission by

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[24] Curiously, these expressed concerns of GTE were omitted from paragraph 72, which mentions only Cincinnati Bell and USTA.